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INTRODUCTION

It is generally accepted that a liability insurer owes a duty to its insured to attempt to settle a claim against the insured within the limits of the insurance policy, in order to protect the insured from a judgment in excess of the policy limits.[1] Some courts have indicated that the insurer's duty is to make a "good faith" attempt to settle;[2] others have said that the insurer must exercise "due care" in attempting to settle;[3] a few have suggested that an insurer should be strictly liable if it refuses to settle a claim within the policy limits.[4]

Recently, the question has arisen as to whether a comparable duty exists between a primary insurer and an excess insurer,[5] and between

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1. Most cases follow a similar pattern, illustrated by the following example. The insurance company issues a liability policy to the insured with a limit of liability of $10,000. The claimant sustains an injury covered by the policy, and files suit against the insured for $20,000. The insurer has an opportunity to settle the claim for $10,000 or less, but rejects the offer in favor of going to trial. A judgment is entered in favor of the claimant for $20,000. Because of its wrongful refusal to settle, the insurer is held liable for the full $20,000, not just the $10,000 policy limit.

2. See notes 25-47 and accompanying text *infra*.

3. See note 48 and accompanying text *infra*.

4. See notes 49-57 and accompanying text *infra*.

5. The operation of excess coverage is described in cases such as *Marwell Constr., Inc. v. Underwriters at Lloyd's, London*, 465 P.2d 298 (Alas. 1970); *Peerless Cas. Co. v. Continental Cas.*

an insured with a deductible and his insurer.[6] Does a primary insurer have a duty to protect the interest of the excess insurer by attempting to settle a claim within the limit of the primary coverage?[7] Does an insured with a deductible clause in his policy have a duty to protect the interest of his insurer by attempting to settle the claim within the amount of the deductible?[8]

Clearly, the general trend throughout the country toward higher dollar judgments will lead to more cases involving these issues. An increasing number of insureds are seeking, or are forced to accept, large self-insured retentions, with insurance coverage coming into the picture only when claims exceed this deductible amount.[9] Insureds are also buying large amounts of excess coverage, and these excess policies are involved in more claims because of the substantial increase in the dollar amount of the claims. Indeed, it is becoming unusual for the amount of an injured person's claim to be within the limits of the primary insurance policy.

Conflict of interest is inherent in these relationships.[10] As a claim reaches or exceeds the amount of a policy limit or deductible, the incentive for the party with the first layer of coverage to litigate becomes strong, because of the ceiling on its exposure to loss. No more can be lost by litigating than would have been lost by settlement, and there is the possibility of gain if the ultimate judgment falls short of the ceiling. On the other hand, the interest of the party responsible for the additional amount of any judgment is in direct conflict, and is always best served by settlement within the ceiling, or as near thereto as possible.

This article will first examine the duty of an insurer to its insured to attempt to settle claims, and will then consider the duty of a primary insurer to its excess insurer, and of an insured to his insurer to settle. This article will then suggest that the relationships between insured, primary insurer and excess insurer engender reciprocal obligations to

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Co., 144 Cal. App. 2d 617, 301 P.2d 602 (1956); and *Liberty Mut. Ins. Co. v. Truck Ins. Exch.*, 245 Or. 30, 420 P.2d 66 (1966). Briefly, an excess policy provides coverage only after the full amount of the underlying primary coverage has been exhausted.

6. Most people are familiar with the use of deductible clauses in automobile and property insurance policies. Deductibles are also being used with increasing frequency in liability insurance policies, especially those of large business firms.

7. The duty to attempt to settle would also include an obligation to tender the full amount of the policy coverage to effectuate a settlement in excess of the policy limit if the excess insurer is willing to contribute the remainder of the settlement.

8. Here also, the duty would include an obligation to tender the full amount of the deductible if the insurer is willing to pay the balance of the settlement offer.

9. This is particularly true in the products liability area. *See generally* Insurance Co. of N. Am. v. Forty-Eight Insulations, Inc., 633 F.2d 1212 (6th Cir. 1980)(asbestos manufacturer had $100,000 deductible in policy).

10. For further discussion of conflict of interest, *see generally* Haskall & Pope, *The Insurer's "Conflict of Interest" Dilemma*, 65 ILL. B.J. 220 (1976); Snow, *Excess Liability—Crisci and Lysick*, 36 INS. COUNS. J. 51 (1969).

give full consideration to the interests of the other parties.[11] Finally, a proposal will be made that each of the parties should be strictly liable for any injury to another party resulting from an attempt to minimize its own liability.

THE INSURER'S DUTY TO SETTLE

In the early years of the twentieth century, an insurer enjoyed almost total immunity from any suit for its failure to settle a case within the policy limits. Most, if not all, courts held that the insurer was free to decide not only the question of whether to settle, but also whether to litigate.[12] A description of the insurer's duties in an early case[13] succinctly captures this early attitude: "The insurer was under no obligation to pay in advance of trial, and the decision whether to settle or to try was committed to it."[14] This view is probably no longer accepted in any jurisdiction, however.

Increasing recognition of the inequities of the bargaining power of the parties[15] has led the courts gradually to redefine the insurer's duties with respect to settlement offers. The contemporary general rule is that, under certain circumstances, an insurer's rejection of a claimant's settlement demand will render the insurer liable for the entire amount of any subsequent judgment.[16] However, great difficulty arises in de-

11. Transit Cas. Corp. v. Spink Corp., 94 Cal. App. 3d 475, 156 Cal. Rptr. 360 (1979).

12. *See, e.g.*, Georgia Cas. Co. v. Mann, 242 Ky. 447, 451, 46 S.W.2d 777, 779 (1932)(insurer has "sole right to settle"); Rumford Falls Paper Co. v. Fidelity & Cas. Co., 92 Me. 574, 583, 43 A. 503, 505 (1899)(insured, under policy, surrenders full and absolute control over settlement to insurer); C. Schmidt & Sons Brewing Co. v. Travelers Ins. Co., 244 Pa. 286, 289, 90 A. 653, 654 (1914)(insurer is not obliged to pay prior to trial).

13. C. Schmidt & Sons Brewing Co. v. Travelers Ins. Co., 244 Pa. 286, 90 A. 653 (1914).

14. *Id.* at 289, 90 A. at 654. The earliest cases often dealt with the simplest solutions. Discussing only the two extremes, the courts rejected strict liability in favor of *no* liability for failure to settle. *See, e.g.*, Kingan & Co. v. Maryland Cas. Co., 65 Ind. App. 301, 313-14, 115 N.E. 348, 351-52 (1917); Rumford Falls Paper Co. v. Fidelity & Cas. Co., 92 Me. 574, 583-84, 43 A. 503, 505-06 (1899); Georgia Cas. Co. v. Cotton Mills Prods. Co., 159 Miss. 396, 412-13, 132 So. 73, 76-77 (1931).

15. By the terms of the insurance policy complete control of the defense of the action is given to the insurer. Ivy v. Pacific Auto Ins. Co., 156 Cal. App. 2d 652, 660, 320 P.2d 140, 146 (1958). This includes the power to negotiate settlements, which is, perhaps, the most important element of control, since the overwhelming majority of tort suits are settled before trial. *See* Note, *Liability Insurance Policy Defenses and the Duty to Defend*, 68 HARV. L. REV. 1436, 1448 (1955).

16. *See, e.g.*, Brown v. Guarantee Ins. Co., 155 Cal. App. 2d 679, 682, 319 P.2d 69, 72 (1957); Rova Farms Resort, Inc. v. Investors Ins. Co. of Am., 65 N.J. 474, 502, 323 A.2d 495, 510 (1974); Hilker v. Western Auto Ins. Co., 204 Wis. 1, 231 N.W. 257 (1930), *aff'd on rehearing*, 204 Wis. 12, 235 N.W. 413 (1931).

Some jurisdictions hold that the duty owed by the insurer to the insured in the conduct of settlement negotiations arises from the insurance contract. Comunale v. Traders & Gen. Ins. Co., 50 Cal. 2d 654, 658, 328 P.2d 198, 200 (1958)("There is an implied covenant of good faith and fair dealing in every contract . . . . This principle is applicable to policies of insurance."); Kulack v. Nationwide Mut. Ins. Co., 47 A.D.2d 418, 420, 366 N.Y.S.2d 927, 929, *rev'd on other grounds*, 40 N.Y.2d 140, 351 N.E.2d 735, 386 N.Y.S.2d 87 (1975) ("a liability insurer . . . has an implied contractual obligation to consider settlement opportunities."); Slater v. Motorists Mut. Ins. Co., 174 Ohio St. 148, 151, 187 N.E.2d 45, 48 (1962)("a liability insurer, collecting premium for the

termining those circumstances. Currently, debate and disagreement abound as to the standard of behavior required of the insurer in excess liability cases and the basis of such liability. Initially, courts found insurers liable for failure to exercise good faith in settlement negotiations.[17] Some jurisdictions later moved to a negligence standard which holds insurers liable for failure to exercise due care in handling settlement negotiations.[18] Recently, some courts have indicated their ap-

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policy issued, owes a duty of protection and good faith to the insured in accordance with the terms of the policy.")

However, other jurisdictions regard breach of the duty owed the insured as a tort. *E.g.*, Fidelity & Cas. Co. v. Gault, 196 F.2d 329 (5th Cir. 1952)(applying Mississippi law); Zumwalt v. Utilities Ins. Co., 360 Mo. 362, 228 S.W.2d 750 (1950); Hart v. Republic Mut. Ins. Co., 152 Ohio St. 185, 188, 87 N.E.2d 347, 349 (1949). For a more modern statement of such origin of the duty, *see generally* Silberg v. California Life Ins. Co., 11 Cal. 3d 452, 521 P.2d 1103, 113 Cal. Rptr. 711 (1974). There the court stated that an insurer's duty is implied in the covenant of good faith and fair dealing which is in every insurance contract. The covenant requires that neither party do anything to injure the other's rights to receive the benefits of the agreement. The insurer's violation of the duty sounds in tort and allows the insured to recover for all detriment resulting from the violation, including mental distress. *Id.* at 460-61, 521 P.2d at 1108-09.

17. *See generally* Brochstein v. Nationwide Mut. Ins. Co., 448 F.2d 987 (2d Cir. 1971)(applying New York law); American Fid. & Cas. Co. v. Greyhound Corp., 258 F.2d 709 (5th Cir. 1958)(applying Florida law); Hall v. Preferred Accident Ins. Co., 204 F.2d 844 (5th Cir. 1953)(applying Georgia law); St. Paul-Mercury Indem. Co. v. Martin, 190 F.2d 455 (10th Cir. 1951)(applying Oklahoma law); American Fid. & Cas. Co. v. G. A. Nichols Co., 173 F.2d 830 (10th Cir. 1949)(applying Oklahoma law); Traders & Gen. Ins. Co. v Rudco Oil & Gas Co., 129 F.2d 621 (10th Cir. 1942)(applying Oklahoma law); Farm Bureau Mut. Auto Ins. Co. v. Violano, 123 F.2d 692 (2d Cir. 1941)(applying Vermont law); Maryland Cas. Co. v. Elmira Coal Co., 69 F.2d 616 (8th Cir. 1934)(applying Missouri law); Maryland Cas. Co. v. Cook-O'Brien Constr. Co., 69 F.2d 462 (8th Cir. 1934)(applying Missouri law); Noshey v. American Auto. Ins. Co., 68 F.2d 808 (6th Cir. 1934)(applying Tennessee law); American Mut. Liab. Ins. Co. v. Cooper, 61 F.2d 446 (5th Cir. 1932)(applying Alabama law); Board of Educ. v. Lumbermen's Mut. Cas. Co., 293 F. Supp. 541 (D.N.J. 1968); Kaudern v. Allstate Ins. Co., 277 F. Supp. 83 (D.N.J. 1967); Christian v. Preferred Accident Ins. Co., 89 F. Supp. 888 (N.D. Cal. 1950); Farmers Ins. Exch. v. Henderson, 82 Ariz. 335, 313 P.2d 404 (1957); Merritt v. Reserve Ins. Co., 34 Cal. App. 3d 858, 110 Cal. Rptr. 511 (1973); Campbell v. Government Employees Ins. Co., 306 So. 2d 525 (Fla. 1974); Koppie v. Allied Mut. Ins. Co., 210 N.W.2d 844 (Iowa 1973); Kohlstedt v. Farm Bureau Mut. Ins. Co., 258 Iowa 337, 139 N.W.2d 184 (1965); Georgia Cas. Co. v. Mann, 242 Ky. 447, 46 S.W.2d 777 (1932); Davis v. Maryland Cas. Co., 16 La. App. 253, 133 So. 769 (1931); Abrams v. Factory Mut. Liab. Ins. Co., 298 Mass. 141, 10 N.E.2d 82 (1937); City of Wakefield v. Globe Indem. Co., 246 Mich. 645, 225 N.W. 643 (1929); Larson v. Anchor Cas. Co., 249 Minn. 339, 82 N.W.2d 376 (1957); Zumwalt v. Utilities Ins. Co., 360 Mo. 362, 228 S.W.2d 750 (1950); Olson v. Union Fire Ins. Co., 174 Neb. 375, 118 N.W.2d 318 (1962); Bowers v. Camden Fire Ins. Ass'n, 51 N.J. 62, 237 A.2d 857 (1968); Knobloch v. Royal Globe Ins. Co., 38 N.Y.2d 471, 344 N.E.2d 364, 381 N.Y.S.2d 433 (1976); Slater v. Motorists Mut. Ins. Co., 174 Ohio St. 148, 187 N.E.2d 45 (1962); Radcliffe v. Franklin Nat'l Ins. Co., 208 Or. 1, 298 P.2d 1002 (1956); Cowden v. Aetna Cas. & Sur. Co., 389 Pa. 459, 134 A.2d 223 (1957); Tyger River Pine Co. v. Maryland Cas. Co., 170 S.C. 286, 170 S.E. 346 (1933); Kunkel v. United Sec. Ins. Co., 84 S.D. 116, 168 N.W.2d 723 (1969); Alford v. National Emblem Ins. Co., 225 Tenn. 379, 469 S.W.2d 375 (1971); Johnson v. Hardware Mut. Cas. Co., 109 Vt. 481, 1 A.2d 817 (1938); Aetna Cas. & Sur. Co. v. Price, 206 Va. 749, 146 S.E.2d 220 (1966); Berk v. Milwaukee Auto. Ins. Co., 245 Wis. 597, 15 N.W.2d 834 (1944).

18. *See generally* State Farm Mut. Auto. Ins. Co. v. Smoot, 381 F.2d 331 (5th Cir. 1957)(applying Georgia law); Ballard v. Ocean Accident & Guar. Co., 86 F.2d 449 (7th Cir. 1936)(applying Wisconsin law); Maryland Cas. Co. v. Wyoming Valley Paper Co., 84 F.2d 633 (1st Cir. 1936)(applying New Hampshire law); Blue Bird Taxi Corp. v. American Fid. & Cas. Co., 26 F. Supp. 808 (E.D.S.C. 1939); Wilson v. Aetna Cas. & Sur. Co., 145 Me. 370, 76 A.2d 111 (1950); Dumas v. State Farm Mut. Auto Ins. Co., 111 N.H. 43, 274 A.2d 781 (1971); Highway Ins. Underwriters v. Lufkin-Beaumont Motor Coaches, Inc., 215 S.W.2d 904 (Tex. Ct. App. 1948).

Some cases have recognized both "bad faith" and "negligence" standards. *See generally* Fidelity & Cas. Co. v. Gault, 196 F.2d 329 (5th Cir. 1952)(applying Mississippi law); Jessen v.

proval of a strict liability standard,[19] though no jurisdiction has expressly adopted and applied such a rule.[20]

Typically, the insurance contract prohibits the insured from settling or interfering with the insurer's negotiations without the insurer's consent.[21] Thus since the insurer has the *right* to defend and settle all claims, the courts have held that the insurer also has a corresponding duty.[22] Under principles of common law, every contract imposes an obligation on the parties to the agreement to perform their respective duties with care, skill, reasonableness and good faith.[23] A duty is implied in every contractual relationship "that neither party shall do anything which will have the effect of destroying or injuring the right of the other party to receive the fruits of the contract; in other words, in every contract there exists an implied covenant of good faith and fair dealing."[24]

O'Daniel, 210 F. Supp. 317 (D. Mont. 1962); Waters v. American Cas. Co., 261 Ala. 252, 73 So. 2d 524 (1953); American Underwriters Ins. Co. v. Shook, 247 Ark. 1082, 449 S.W.2d 402 (1970); Olympia Fields Country Club v. Bankers Indem. Ins. Co., 325 Ill. App. 649, 60 N.E.2d 896 (1945); Rector v. Husted, 214 Kan. 230, 519 P.2d 634 (1974); Rutter v. King, 57 Mich. App. 152, 226 N.W.2d 79 (1974); Farmers Gin Co. v. St. Paul-Mercury Indem. Co., 186 Miss. 747, 191 So. 415 (1939); Boling v. New Amsterdam Cas. Co., 173 Okla. 160, 46 P.2d 916 (1935); Hilker v. Western Auto Ins. Co., 204 Wis. 1, 231 N.W. 257 (1931). One court held that a defendant was "negligent to the extent of bad faith." Tully v. Travelers Ins. Co., 118 F. Supp. 568 (N.D. Fla. 1954). Others have expressed the opinion that negligence is one factor to consider in determining bad faith.

19. *See generally* Crisci v. Security Ins. Co., 66 Cal.2d 425, 426 P.2d 173, 58 Cal. Rptr. 13 (1967); Rova Farms Resort, Inc. v. Investors Ins. Co. of America, 65 N.J. 474, 323 A.2d 495 (1974).

20. Some courts have expressly disavowed the standard. *See, e.g.*, DeGraw v. State Sec. Ins. Co., 40 Ill. App. 3d 26, 37, 351 N.E.2d 302, 311-12 (1976); Knobloch v. Royal Globe Ins. Co., 38 N.Y.2d 471, 479, 344 N.E.2d 364, 369, 381 N.Y.S.2d 433, 437-38 (1976).

21. A typical liability insurance policy provides:

> The company will pay on behalf of the insured all sums which the insured shall become legally obligated to pay as damages because of
>
> A. bodily injury
>
> B. property damage
>
> . . . caused by an occurrence, and the company shall have the right and duty to defend any suit against the insured seeking damages on account of bodily injury or property damage . . . and may make such investigation and settlement of any claim or suit as it deems expedient.

DEFENSE RESEARCH INSTITUTE, ANNOTATED COMPREHENSIVE GENERAL LIABILITY INSURANCE POLICY 67 (1979); *see* Merritt v. Reserve Ins. Co., 34 Cal. App. 3d 858, 870, 110 Cal. Rptr. 511, 519 (1973) (interpreting such provisions as giving the insurer exclusive control of settlement and preventing the insured from exercising independent action). For a general discussion of the insurer's duty to defend, *see* 7C J. APPELMAN, INSURANCE LAW AND PRACTICE §4682 (1979); 14 G. COUCH, CYCLOPEDIA OF INSURANCE LAW §51:32 (2d ed. 1965); Note, *Liability Insurance Policy Defenses and the Duty to Defend*, 68 HARV. L. REV. 1436 (1955).

22. *See* Podolsky v. Devinney, 281 F. Supp. 488, 494 (S.D.N.Y. 1968).

23. Bak-A-Lum Corp. of Am. v. Alcoa Bldg., 66 N.J. 123, 129-30, 351 A.2d 349, 352 (1976) (quoting Associate Group Life, Inc. v. Catholic War Veterans, 61 N.J. 150, 153, 293 A.2d 382, 384 (1972)).

24. 5 S. WILLISTON, A TREATISE ON THE LAW OF CONTRACTS §670, at 159 (3d ed. W. Jaeger 1961).

TESTS FOR BREACH OF THE INSURER'S DUTY TO THE INSURED

A. Bad Faith—Fraud

While the vast majority of jurisdictions today apply a good faith standard in excess liability cases,[25] there is no agreement as to what conduct on the insurance company's part constitutes bad faith. It has been said: "Bad faith is a general and somewhat indefinite term. It has no constricted meaning. It cannot be defined with exactness. It is not simply bad judgment. It is not merely negligence."[26]

Some courts have equated bad faith with fraudulent behavior by the insurer,[27] involving actual intent and conscious wrongdoing.[28] By the very nature of this bad faith test, an insured's recovery for his insurer's refusal to settle was difficult. The test did not put much pressure on recalcitrant insurance companies to settle, nor did it hold insurers to a high standard of conduct. As a result, most jurisdictions have adopted a more liberal standard for testing bad faith.

B. The Modern Test of Good Faith

Many jurisdictions have rejected the traditional view that bad faith equates with fraud, and have focused instead upon the insurer's fiduciary duties to the insured. These jurisdictions define bad faith in terms of the breach of the fiduciary duties owed to the insured.[29] Such an approach favors the insured since proving ill will is very difficult, and courts are reluctant to find fraud.

Most jurisdictions now define good faith by stating that the insurer must give equal consideration to its interests and to the interests of its insured,[30] but some go further by insisting that the company give paramount consideration to the interests of its insured to the disfavor of its

25. *See, e.g.*, Transport Ins. Co. v. Michigan Mut. Liab. Ins. Co., 496 F.2d 265 (6th Cir. 1974)(applying Michigan law); Peterson v. Allcity Ins. Co., 472 F.2d 71 (2d Cir. 1972)(applying New York law); Fulton v. Woodford, 26 Ariz. App. 17, 545 P.2d 979 (1976); Kooyman v. Farm Bureau Mut. Ins. Co., 267 N.W.2d 403 (Iowa 1978); Colsch v. Travelers Ins. Co., 361 Mass. 873, 281 N.E.2d 593 (1972); New Amsterdam Cas. Co. v. Lundquist, 293 Minn. 274, 198 N.W.2d 543 (1972); Slater v. Motorists Mut. Ins. Co., 174 Ohio St. 148, 187 N.E.2d 45 (1962); Gedeon v. State Farm Mut. Auto. Ins. Co., 410 Pa. 55, 188 A.2d 320 (1963).

26. Spiegel v. Beacon Participations, Inc., 297 Mass. 398, 416, 8 N.E.2d 895, 907 (1937).

27. *See, e.g.*, Harrod v. Meridian Mut. Co., 389 S.W.2d 74, 76 (Ky. 1964); Slater v. Motorists Mut. Ins. Co., 174 Ohio St. 148, 151, 187 N.E.2d 45, 48 (1962); Johnson v. Hardware Mut. Cas. Co., 108 Vt. 269, 286, 187 A. 788, 796 (1936).

28. *See, e.g.*, 108 Vt. at 286, 187 A. at 796 (bad faith refers to a real and actual state of mind capable of both direct and circumstantial proof); Berk v. Milwaukee Auto Ins. Co., 245 Wis. 597, 601, 15 N.W.2d 834, 836 (1944)("[b]ad faith is a species of fraud, and the evidence to sustain a finding thereof must be clear, satisfactory, and convincing").

29. *See generally* United States Fid. & Guar. Co. v. Lembke, 328 F.2d 569 (10th Cir. 1964)(applying Colorado law); Brown v. Guarantee Ins. Co., 155 Cal. App. 2d 679, 319 P.2d 69 (1957); Cernocky v. Indemnity Ins. Co., 69 Ill. App. 2d 196, 216 N.E.2d 198 (1966).

30. *See generally* Hernandez v. Employers Mut. Liab. Ins. Co., 346 F.2d 154 (5th Cir. 1965)(applying Louisiana law); Ballard v. Citizens Cas. Co., 196 F.2d 96 (7th Cir. 1952)(applying

own when the two conflict.[31] Definitions of the insurer's duty to consider the insured's interests as either paramount or equal to its own do not provide a very meaningful or clear distinction.[32] However, many courts state that the insurer can demonstrate its good faith in handling negotiations for settlement by acting as if there were no policy limits applicable to the claim and as if the risk of loss was entirely its own.[33] Conversely, bad faith is normally demonstrated by proving that the risk of an unfavorable result was out of proportion to the chances of a favorable outcome.[34]

C. California Cases

Despite the fact that California adheres to the "equal consideration" language,[35] in practice it applies the strictest excess liability rules. In 1967,[36] California adopted the Keeton standard,[37] which requires that an insurer's settlement conduct conform to that of an "ordinary prudent insurer with no policy limit."[38] But California has gone a step further than most other states which have adopted this standard.[39] When a judgment over the policy limits is rendered, California law applies a rebuttable presumption that any previous settlement demand

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Illinois law); General Accident Fire & Life Assurance Corp. v. Little, 103 Ariz. 435, 443 P.2d 690 (1968).

31. *See* Zumwalt v. Utilities Ins. Co., 360 Mo. 362, 373, 228 S.W.2d 750, 756 (1950). *See generally* Rova Farms Resort, Inc. v. Investors Ins. Co. of America, 65 N.J. 474, 323 A.2d 495 (1974); Tiger River Pine Co. v. Maryland Cas. Co., 170 S.C. 286, 170 S.E. 346 (1933).

32. Keeton, *Liability Insurance and Responsibility for Settlement*, 67 HARV. L. REV. 1136, 1141 (1954) [hereinafter cited as Keeton]. Professor Keeton has suggested that there is no practical difference in the results, since under either standard the question is one for the jury.

33. *See generally* Bollinger v. Nuss, 202 Kan. 326, 449 P.2d 502 (1969)(insurer must evaluate claim without looking at policy limits and as though it would be responsible for entire amount of any judgment rendered on claim); Lange v. Fidelity & Cas. Co., 290 Minn. 61, 185 N.W.2d 881 (1971)(insurer must view situation as it would if there were no policy limits applicable to claim); Bowers v. Camden Fire Ins. Ass'n, 51 N.J. 62, 237 A.2d 857 (1968)(where adverse verdict probably will exceed limits, insurer can refuse settlement in "good faith" only by treating settlement offer as if insured had full coverage for whatever verdict might be recovered); Crabb v. National Indem. Co., 87 S.D. 222, 205 N.W.2d 633 (1973)(insurer must in good faith view the situation as it would if there were no policy limits applicable to the claim).

34. *See generally* Eastham v. Oregon Auto. Ins. Co., 273 Or. 600, 540 P.2d 364, *rehearing denied*, 273 Or. 600, 542 P.2d 895 (1975).

35. Comunale v. Traders & Gen. Ins. Co., 50 Cal. 2d 654, 659, 328 P.2d 198, 201 (1958).

36. Crisci v. Security Ins. Co., 66 Cal. 2d 425, 431-32, 426 P.2d 173, 176, 58 Cal. Rptr. 13, 16 (1967).

37. Keeton, *supra* note 32, at 1147.

38. Keeton, *supra* note 32, at 1147.

39. *See generally* Board of Educ. v. Lumbermen's Mut. Cas. Co., 293 F. Supp. 541 (D.N.J. 1968); General Accident Fire & Life Assurance Corp. v. Little, 103 Ariz. 435, 442, 443 P.2d 690, 697 (1968); Koppie v. Allied Mut. Ins. Co., 210 N.W.2d 844 (Iowa 1973); Rector v. Husted, 214 Kan. 230, 519 P.2d 634 (1974); Lange v. Fidelity & Cas. Co., 290 Minn. 61, 185 N.W.2d 881 (1971); Dumas v. Hartford Accident & Indem. Co., 94 N.H. 484, 56 A.2d 57 (1947); Rova Farms Resort, Inc. v. Investors Ins. Co., 65 N.J. 474, 323 A.2d 495 (1974); Radcliffe v. Franklin Nat'l Ins. Co., 208 Or. 1, 298 P.2d 1002 (1956); Cowden v. Aetna Cas. & Sur. Co., 389 Pa. 459, 134 A.2d 223 (1957); Crabb v. National Indem. Co., 87 S.D. 222, 205 N.W.2d 633 (1973).

under the limits was reasonable.[40] Thus, in excess liability cases in California, the insurer bears the burden of showing that the settlement demand was unreasonable.[41] The resulting standard is only a small step removed from strict liability, as recent cases have confirmed.[42]

As a California court pointed out, applying the "equal consideration" doctrine calls for an assessment of factors such as:

> The strength of the injured claimant's case on the issues of liability and damages; attempts by the insurer to induce the insured to contribute to a settlement; failure of the insurer to properly investigate the circumstances so as to ascertain the evidence against the insured; the insurer's rejection of advice of its own attorney or agent; failure of the insurer to inform the insured of a compromise offer; the amount of financial risk to which each party is exposed in the event of a refusal to settle; the fault of the insured in inducing the insurer's rejection of the compromise offer by misleading it as to the facts; and any other factors tending to establish or negate bad faith on the part of the insurer.[43]

Broad support is also developing for the view that an insurance company must take more than a passive role, and "that, in some circumstances at least it has an affirmative duty to seize whatever reasonable opportunity may present itself to protect its insured from excess liability."[44] The insurer must explore all settlement possibilities and, if nec-

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40. 66 Cal. 2d at 431, 426 P.2d at 177, 58 Cal. Rptr. at 17.

41. This presumably means that the insurer must show that accepting the settlement demand would not be consistent with rational settlement behavior, since an insurer with no limits generally would be expected to exercise rational settlement behavior. The insurer would therefore be required to show either that the damages should have been substantially less than those actually awarded in the tort suit, or that there was significant uncertainty about the outcome of the liability issue in the tort suit, or both. It is unlikely, following a tort suit won by the claimant, that the insurer could successfully show either.

42. *See generally* Johansen v. California State Auto. Ass'n Inter-Ins. Bureau, 15 Cal. 3d 9, 538 P.2d 744, 123 Cal. Rptr. 288 (1975). It has been argued, in fact, that *Johansen* and other post-*Crisci* cases have established an "unannounced" policy of strict liability in California. Note, Johansen v. California State Automobile Association: *Has California Adopted Strict Liability for an Insurer's Failure to Settle?* 27 HASTINGS L.J. 895, 911 (1976).

43. Brown v. Guarantee Ins. Co., 155 Cal. App. 2d 679, 689, 319 P.2d 69, 75 (1957). Besides the seven standards enunciated in *Brown*, legal writers have offered other factors which could be considered. Jarrett, *Lawsuits for Wrongful Refusal to Defend or to Settle*, 28 INS. COUNS. J. 58, 65 (1961) enumerated eleven additional factors affecting good faith: did the insurer reject a compromise offer after an excess verdict had been entered; does the insurer have reinsurance as protection; did the insurer advise its insured to transfer his assets to parties immune from a potential excess judgment; did the insurer make any remark regarding the low limit of the policy as being an advantage of the case; did the insurer make a subjective evaluation of the claimant's witnesses; did the insurer favor going to trial because the insured was judgment-proof; did the insurer reject a settlement because all the plaintiffs refused to join; did the insurer increase its reserves after it rejected a settlement offer; did the insurer establish an arbitrary settlement figure lower than the policy limits; did the insurer have a representative at the trial to increase the settlement offer if the trial went badly; and, did the insurer indicate a willingness to offer the full amount and then fail to do so or did the agent fail to offer all that was available?

See also CAL. INS. CODE §790.03(h)(1)-(15) in which the state legislature codified 13 unfair claims settlement practices.

44. Alt v. American Family Mut. Ins. Co., 71 Wis. 2d 340, 350, 237 N.W.2d 706, 713 (1976).

essary, initiate negotiations with the claimant.[45] The insurer should not bargain defensively, but should take positive steps toward settling within the policy limits.[46] Breach of either of these duties will indicate bad faith, and the burden will shift to the insurer to demonstrate that there was no possibility of effecting a settlement within the policy limits or at a higher figure to which the insured might have contributed.[47]

D. Negligence

Some courts frame the insurer's duty to the insured only in terms of good faith, while others apply a negligence test requiring both good faith and reasonable care. Under the latter test, an insurer incurs excess liability when "it fails to settle when a reasonable man with unlimited exposure in the exercise of due care would have settled."[48] In practice, there is probably little distinction between the two standards as the courts apply them to fact situations. Because good faith is a state of mind which can be established only through examination of conduct, the same conduct which one court finds to be negligent is likely to be found by another court to be indicative of bad faith.

E. Strict Liability

In response to the difficulties encountered in imposing liability for the breach of an insurance carrier's settlement duty, strict liability for this failure has been urged in some jurisdictions. In suggesting strict liability, the Supreme Court of New Jersey, in *Rova Farms Resort, Inc. v. Investors Insurance Co.*, stated that[49]

> where the carrier chooses not to offer the limits of coverage, one wonders whether it should not bear the unhappy financial result of that unilateral decision, since it alone profits from the opposite result of the gamble. This result would enable the insurer to pursue its own interests in great measure without sacrificing those of its insured so long as it was clear by whom the burden of mistake should be borne. The kind of rule we project, which would settle the nagging conflicts of interest under present law, has already been regarded favorably by some.[50]

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45. Rova Farms Resort, Inc. v. Investors Ins. Co. of America, 65 N.J. 474, 493, 496, 323 A.2d 495, 505, 507 (1974). *See also* State Auto. Ins. Co. v. Rowland, 221 Tenn. 421, 427 S.W.2d 30 (1968)(even if claimant does not offer to settle within policy limit, insurer *may* be guilty of bad faith if it does not try to settle, where liability is clear and there is good chance of excess judgment).

46. 65 N.J. at 495-96, 323 A.2d at 506-07.

47. *Id.* at 496, 323 A.2d at 507.

48. Radio Taxi Serv., Inc. v. Lincoln Mut. Ins. Co., 31 N.J. 299, 303, 157 A.2d 319, 322 (1960).

49. 65 N.J. 474, 323 A.2d 495 (1974).

50. *Id.* at 500, 323 A.2d at 509-10.

The California courts have also indicated support for a strict liability standard.[51] After finding ample evidence of bad faith in *Crisci*,[52] the court went on to state that "there is more than a small amount of elementary justice in a rule that would require that, in this situation where the insurer's and insured's interests necessarily conflict, the insurer, which may reap the benefits of its determination not to settle, should also suffer the detriments of its decision."[53]

In a later case,[54] an appellate court in California indicated its approval of a rule which comes very close to strict liability:

> An insurer who denies coverage does so at its own risk, and, although its position may not have been entirely groundless, if the denial is found to be wrongful it is liable for the full amount which will compensate the insured for all detriment caused by the insurer's breach of the express and implied obligations of the contract.[55]

In affirming,[56] the California Supreme Court based its decision on a finding of bad faith, as had the appellate court, but it said nothing that would indicate any disapproval of the proposed rule of strict liability.

Although no state has expressly adopted and applied a strict liability standard, a review of the excess liability cases in California reveals that the application of the current "bad faith" test leads to almost certain recovery of the excess judgment when the insurance company has rejected a settlement offer within the policy limits.[57] In view of this, a straightforward adoption of the strict liability rule would seem to be a sensible approach.[58]

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51. *Contra*, Hodges v. Standard Accident Ins. Co., 198 Cal. App. 2d 564, 576, 18 Cal. Rptr. 17, 24 (1962)(extending liability to every case where insurer rejects offer of settlement below policy limits is not necessary for protection of insured's interests).

52. *See generally* Crisci v. Security Ins. Co., 66 Cal. 2d 425, 426 P.2d 173, 58 Cal. Rptr. 13 (1967).

53. *Id.* at 431, 426 P.2d at 177, 58 Cal. Rptr. at 17.

54. Egan v. Mutual of Omaha, 63 Cal. App. 3d 659, 133 Cal. Rptr. 899 (1976).

55. *Id.* at 675, 133 Cal. Rptr. at 909.

56. 24 Cal. 3d 809, 598 P.2d 452, 157 Cal. Rptr. 482 (1979).

57. In only two reported California cases in recent years was the insurer absolved of liability for the excess judgment: *Coe v. State Farm Auto. Ins. Co.*, 66 Cal. App. 3d 981, 136 Cal. Rptr. 331 (1977) and *Hodges v. Standard Accident Ins. Co.*, 198 Cal. App. 2d 564, 18 Cal. Rptr. 17 (1962). There are many California cases in which the insurer was held liable, *see generally* Comment, *Approaching Strict Liability of Insurer for Refusal to Settle Within Policy Limits*, 47 NEB. L. REV. 705 (1968); Note, *Insurer's Liability for Refusal to Settle: Beyond Strict Liability*, 50 S. CAL. L. REV. 751 (1977); Comment, *Liability in Excess of Insurance Policy Limits, Who Bears the Risk of Litigation?*, 12 TOLEDO L. REV. 101 (1980).

58. See notes 146-156 and accompanying text *infra*. Many commentators have expressed support for the strict liability standard. *See, e.g.*, Kelly, *The Workable Sanction and Solution in Excess Liability Cases: Strict Liability for Insurance Carriers*, 10 U.S.F. L. REV. 159 (1975); Levit, *The* Crisci *Case—Something Old, Something New*, 1968 INS. L. J. 12; Locke & Austin, *Handling the Excess Coverage Situation for the Insurer*, 36 INS. COUNS. J. 51 (1969); Meyer, Gray v. Nationwide *& Beyond*, 71 DICK. L. REV. 257 (1967); Schwartz, *Statutory Strict Liability for an Insurer's Failure to Settle: A Balanced Plan for an Unresolved Problem*, 1975 DUKE L.J. 901; Snow, *Excess Liabilty*—Crisci *and* Lysick, 36 INS. COUNS. J. 51 (1969); Snyder, *Defense in Excess of Policy Limit Litigation*, 18 FED'N INS. COUNS. Q. 9 (Winter 1967-68); Note, *Recent Developments in the Excess*

DUTY OF PRIMARY INSURER TO EXCESS INSURER

A. Is There a Duty?

When the primary insurer fails to settle at or near its policy limits and negligently or in bad faith elects to take its chances with a possible excess verdict, the excess insurance carrier is put in the same position as the insured. Neither may legally or contractually control any of the proceedings in the lawsuit, while both are going to have to pay the amount of judgment in excess of the primary policy limit.

Because of its greater knowledge and experience in insurance matters, an excess carrier might sometimes be held by the courts to a greater degree of responsibility for looking out for itself than the insured.[59] However, the relationship between an excess insurer and the primary insurer has usually been based upon equitable subrogation wherein the excess insurer stands in the shoes of its insured.[60] In view of that, an excess carrier should not be charged with any superior knowledge. Yet, it is plain that judges and juries, being human, cannot look at an insurance company and see it the same as they see an individual insured.

In any case, it would seem that the excess carrier should be in exactly the same position as an individual insured because it cannot legally force the primary insurer to settle.[61] It is true that the excess insurer could contribute to a settlement within the policy limits on potentially serious cases, but the same is true as to the insured and, by doing so, both find themselves in a distastefully compromising situation, especially in reference to the excess carrier who may be setting a precedent for the future.

The great weight of authority supports the existence of a duty owed

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Judgment Suit, 36 BROOKLYN L. REV. 464 (1970); Note, Johansen v. California State Automobile Association: *Has California Adopted Strict Liability for an Insurer's Failure to Settle?*, 27 HASTINGS L.J. 895 (1976); Note, *Insurance: Duty of Liability Insurer to Accept Offer of Settlement Within Policy Limits*, 10 HASTINGS L.J. 198 (1958); Comment, *Insurance—Liability of Insurer for Judgment in Excess of Policy Limits*, 48 MICH. L. REV. 95 (1949); Comment, *Approaching Strict Liability of Insurer for Refusing to Settle Within Policy Limits*, 47 NEB. L. REV. 705 (1968); Comment, *Insurance—Excess Recovery—Liability Insurer Who Refused Settlement Within the Policy Limits Held Liable for Excess Recovery and Mental Damages*, 43 N.Y.U. L. REV. 199 (1968); Comment, *Insurance: Liability for Refusal to Settle Within the Policy Limits—The* Crisci *Case and Oklahoma Law*, 22 OKLA. L. REV. 440 (1969); Note, *An Insurance Company's Duty to Settle: Qualified or Absolute?*, 41 S. CAL. L. REV. 120 (1968).

59. *See generally* Knepper, *Relationships Between Primary and Excess Carriers in Cases Where Judgment or Settlement Value Will Exhaust the Primary Coverage*, 20 INS. COUNS. J. 207 (1953).

60. *E.g.*, Peter v. Travelers Ins. Co., 375 F. Supp. 1347 (C.D. Cal. 1974). See notes 67-75 and accompanying text *infra*.

61. Normally, the primary carrier has complete control of the defense, both in cases where there is excess insurance and in cases where there is not. See note 21 *supra*.

by a primary insurer to an excess insurer.[62] The case most often cited for this principle, *American Fidelity & Casualty Co. v. All American Bus Lines, Inc.*,[63] involved an injured party who obtained a verdict in excess of the primary policy limits after the primary insurer had refused to settle. The court held that an excess insurer could recover against the primary insurer, where the primary insurer was guilty of bad faith in not settling the claim within the limits of the primary policy.[64]

B. Source of Duty

Most of the cases which have recognized that a primary insurer may be responsible to an excess insurer for an excess judgment have found that the right of the excess carrier was derived from subrogation[65] or assignment.[66]

Peter v. Travelers Insurance Co.[67] was one of the first cases to clearly

62. *See generally* Portland Gen. Elec. Co. v. Pacific Indem. Co., 574 F.2d 469 (9th Cir. 1978)(applying Oregon law); United States Fid. & Guar. Co. v. Tri-State Ins. Co., 285 F.2d 579 (10th Cir. 1960)(applying Oklahoma law); American Fid. & Cas. Co. v. All American Bus Lines, Inc., 179 F.2d 7 (10th Cir. 1950)(applying Oklahoma law); Offshore Logistics Services, Inc. v. Arkwright-Boston Mfrs Mut. Ins. Co., 469 F. Supp. 1099 (E.D. La. 1979)(dictum); Vencill v. Continental Cas. Co., 433 F. Supp. 1371 (S.D.W. Va. 1977); Transport Ins. Co. v. Michigan Mut. Liab. Ins. Co., 340 F. Supp. 670 (E.D. Mich. 1972); General Accident Fire & Life Assurance Corp. v. American Cas. Co., 390 So. 2d 761 (Fla. App. 1980); Ranger Ins. Co. v. Travelers Indem. Co., 389 So. 2d 272 (Fla. App. 1980); Citizens Mut. Ins. Co. v. Nationwide Ins. Co., 29 Mich. App. 91, 185 N.W.2d 99 (1970)(dictum); Continental Cas. Co. v. Reserve Ins. Co., 307 Minn. 5, 238 N.W.2d 862 (1976); Allstate Ins. Co. v. Reserve Ins. Co., 116 N.H. 806, 373 A.2d 339 (1977); Western World Ins. Co. v. Allstate Ins. Co., 150 N.J. Super. 481, 376 A.2d 177 (1977); Estate of Penn v. Amalgamated Gen. Agencies, 148 N.J. Super. 419, 372 A.2d 1124 (1977); St. Paul Fire & Marine Ins. Co. United States Fid. & Guar. Co., 43 N.Y.2d 977, 375 N.E.2d 733, 404 N.Y.S.2d 522 (1978); Home Ins. Co. v. Royal Indem. Co., 68 Misc. 2d 737, 327 N.Y.S.2d 745, *aff'd without opinion*, 39 A.D.2d 678, 332 N.Y.S.2d 1003, *leave to appeal denied*, 31 N.Y.2d 641 (1972); Centennial Ins. Co. v. Liberty Mut. Ins. Co., 62 Ohio St. 2d 221, 404 N.E.2d 759 (1980)(dictum). See notes 90-100 and accompanying text *infra* for discussion of the California cases.

63. 190 F.2d 234 (10th Cir.), *cert. denied*, 342 U.S. 851 (1951).

64. *Id.* at 238. Those jurisdictions which have recognized that the primary carrier owes a duty to the excess carrier have measured the performance of the duty by the same standard applied to the duty of the primary carrier to the insured, that is, bad faith, negligence, etc.

65. *See generally* Portland Gen. Elec. Co. v. Pacific Indem. Co., 574 F.2d 469 (9th Cir. 1978)(applying Oregon law); Valentine v. Aetna Ins. Co., 564 F.2d 292 (9th Cir. 1977)(applying California law); American Fid. & Cas. Co. v. All American Bus Lines, Inc., 190 F.2d 234 (10th Cir.), *cert. denied*, 342 U.S. 851 (1951)(applying Oklahoma law); Vencill v. Continental Cas. Co., 433 F. Supp. 1371 (S.D.W. Va. 1977); Peter v. Travelers Ins. Co., 375 F. Supp. 1347 (C.D. Cal. 1974); Transport Ins. Co. v. Michigan Mut. Liab. Ins. Co., 340 F. Supp. 670 (E.D. Mich. 1972); Northwestern Mut. Ins. Co. v. Farmers Ins. Group, 76 Cal. App. 3d 1031, 143 Cal. Rptr. 415 (1978); General Accident Fire & Life Assur. Corp. v. American Cas. Co., 390 So. 2d 761 (Fla. App. 1980); Ranger Ins. Co. v. Travelers Indem. Co., 389 So. 2d 272 (Fla. App. 1980); Continental Cas. Co. v. Reserve Ins. Co., 307 Minn. 5, 238 N.W.2d 862 (1976); Allstate Ins. Co. v. Reserve Ins. Co., 116 N.H. 806, 373 A.2d 339 (1977); Estate of Penn v. Amalgamated Gen. Agencies, 148 N.J. Super. 419, 372 A.2d 1124 (1977); Home Ins. Co. v. Royal Indem. Co., 68 Misc. 2d 737, 327 N.Y.S.2d 745, *aff'd without opinion*, 39 A.D.2d 678, 332 N.Y.S.2d 1003, *leave to appeal denied*, 31 N.Y.2d 641 (1972); Centennial Ins. Co. v. Liberty Mut. Ins. Co., 62 Ohio St. 2d 221, 404 N.E.2d 759 (1980).

66. *See generally* Allstate Ins. Co. v. Reserve Ins. Co., 116 N.H. 806, 373 A.2d 339 (1977).

67. 375 F. Supp. 1347 (C.D. Cal. 1974).

articulate that the source of the duty was subrogation.[68] The court stated that "the duty owed the excess insurer is identical to that owed the insured."[69] Similarly, the court in *Continental Casualty Co. v. Reserve Insurance Co.*[70] said: "We hold that an excess insurer is subrogated to the insured's rights against a primary insurer for breach of the primary insurer's good-faith duty to settle."[71] This does not mean that an excess insurer can force the primary insurer to pay its full policy limit in settlement in every case, or risk the threat of liability for the full amount of a possible judgment if settlement is refused.[72] It merely means that it must tender all or part of its policy limit if that is what a prudent insurer with a "no limit" policy would do.[73]

> When there is no excess insurer, the insured becomes his own excess insurer, and his single primary insurer owes him a duty of good faith in protecting him from an excess judgment and personal liability. *If the insured purchases excess coverage, he in effect substitutes an excess insurer for himself.* It follows that the excess insurer should assume the rights as well as the obligations of the insured in that position.[74]

Nor will it suffice for the primary insurer to argue that the insured has suffered no loss to which the excess insurer can be subrogated. It is not necessary that the subrogor-insured suffered *actual* loss; "it is required only that he would have suffered loss had the subrogee (excess insurer) not discharged the liability or paid the loss."[75]

Other theories which have been advanced are that the excess carrier is a third party beneficiary of the contract between the insured and the

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68. The court stated that the requirements for subrogation, under California law, are: (1) The insured has suffered a loss for which the party to be charged is liable, either because the latter is a wrongdoer whose act or omission caused the loss or because he is legally responsible to the insured for the loss caused by the wrongdoer; (2) the insurer, in whole or in part, has compensated the insured for the same loss for which the party to be charged is liable; (3) the insured has an existing, assignable cause of action against the party to be charged, which action the insured could have asserted for his own benefit had he not been compensated for his loss by the insurer; (4) the insurer has suffered damages caused by the act or omission upon which the liability of the party to be charged depends; (5) justice requires that the loss should be entirely shifted from the insurer to the party to be charged, whose equitable position is inferior to that of the insurer; and (6) the insurer's damages are in a stated sum, usually the amount it has paid to its insured, assuming the payment was not voluntary and was reasonable. Patent Scaffolding Co. v. William Simpson Constr. Co., 256 Cal. App. 2d 506, 509, 64 Cal. Rptr. 187, 190 (1967).

375 F. Supp. at 1350.

69. 375 F. Supp. at 1350.

70. 307 Minn. 5, 238 N.W.2d 862 (1976).

71. *Id.* at 8, 238 N.W.2d at 864.

72. *See* St. Paul-Mercury Indem. Co. v. Martin, 190 F.2d 455, 457 (10th Cir. 1951).

73. See notes 32-37 and accompanying text *supra*.

74. Continental Cas. Co. v. Reserve Ins. Co., 307 Minn. 5, 8-9, 238 N.W.2d 862, 864 (1976) (emphasis added).

75. Northwestern Mut. Ins. Co. v. Farmers Ins. Group, 76 Cal. App. 3d 1031, 1044, 143 Cal. Rptr. 415, 423 (1978).

primary insurer,[76] or that the primary insurer owes a direct duty to the excess insurer without regard to subrogation.[77] A California court[78] clearly recognized the existence of a duty to the excess insurer by stating that there is a three way relationship creating reciprocal obligations among insured, primary insurer, and excess insurer.[79] Still other courts have simply stated that the duty to the excess carrier exists, without indicating the source of the duty.[80]

It seems reasonable to take the position that the duty to the excess insurer is direct, rather than being derived from subrogation. It is clear that if the insured has excess coverage he doesn't care if there is an excess judgment. Thus, it seems rather peculiar that the excess carrier's rights against the primary carrier should arise by stepping into the shoes of the insured. The excess carrier is, however, a foreseeably injured party if the primary carrier conducts settlement negotiations, or discharges its other duties, negligently or in bad faith, and there should be a direct cause of action against the primary carrier.

It appears that only one jurisdiction has held that the primary carrier owes no duty to the excess carrier,[81] and even there the authority of the court's rejection of the duty is weakened because the fact situation was atypical. In the usual situation, the insured has directly contracted for a primary insurance policy and an excess insurance policy, and there is no question about the contractual responsibilities of the insurers to the insured.

In *Universal Underwriters v. Dairyland Mutual Insurance Co.*,[82] however, Dairyland Mutual insured the negligent driver of a vehicle, with a policy limit of $10,000, and Universal Underwriters insured the owner of this vehicle[83] which caused an accident. Dairyland denied that its coverage was applicable to the accident, and refused to defend.[84] Uni-

76. *See* Portland Gen. Elec. v. Pacific Indem. Co., 579 F.2d 514, 515 (9th Cir. 1978)(applying Oregon law).

77. United States Fid. & Guar. Co. v. Tri-State Ins. Co., 285 F.2d 579, 581 (10th Cir. 1960)(applying Oklahoma law). *Contra*, Allstate Ins. Co. v. Reserve Ins. Co., 116 N.H. 806, 808, 373 A.2d 339, 340 (1977).

78. Transit Cas. Corp. v. Spink Corp., 94 Cal. App. 3d 124, 156 Cal. Rptr. 360 (1979).

79. *Id.* at 134, 156 Cal. Rptr. at 367. A subrogation theory might have resulted in no recovery in *Transit Casualty*, because of the wrongful conduct of the insured.

80. *See generally* St. Paul-Mercury Indem. Co. v. Martin, 190 F.2d 455 (10th Cir. 1951)(applying Oklahoma law); Offshore Logistics Services, Inc. v. Arkwright-Boston Mfrs. Mut. Ins. Co., 469 F. Supp. 1099 (E.D. La. 1979); Kaiser Foundation Hospitals v. North Star Reins. Corp., 90 Cal. App. 3d 786, 153 Cal. Rptr. 678 (1979); Citizens Mut. Ins. Co. v. Nationwide Ins. Co., 29 Mich. App. 91, 185 N.W.2d 99 (1970); St. Paul Fire & Marine Ins. Co. v. United States Fid. & Guar. Co., 43 N.Y.2d 977, 375 N.E.2d 733, 404 N.Y.S.2d 522 (1978).

81. *See generally* Universal Underwriters Ins. Co. v. Dairyland Mut. Ins. Co., 102 Ariz. 518, 433 P.2d 966 (1967). This case was expressly followed in Rocky Mountain Fire & Cas. Co. v. Dairyland Ins. Co., 452 F.2d 603 (9th Cir. 1971).

82. 102 Ariz. 518, 433 P.2d 966 (1967).

83. Under a garage liability policy.

84. The court subsequently held that, under Arizona law, the Dairyland policy was the pri-

versal then settled with the claimant for $30,000, and sued Dairyland, seeking to recover the full $30,000 on the theory that Dairyland was guilty of bad faith to its insured (and, through the insured, to Universal) because it failed to defend and pay the judgment.

The court rejected this argument, and allowed Universal to recover from Dairyland only the latter's policy limit of $10,000. The court found it unnecessary to determine whether Dairyland had exercised good faith toward its insured, since this would not affect the rights of Universal, privity of contract between the insurers being absent. In the court's view, the only duty which Dairyland owed to Universal was to pay its $10,000 policy limit toward satisfaction of the judgment.

As the Ninth Circuit Court of Appeals properly recognized in *Rocky Mountain Fire & Casualty Co. v. Dairyland Insurance Co.*,[85] the rejection by the Arizona Supreme Court of any duty of the primary insurer to the excess insurer was clearly dictum.[86] There was no indication that settlement negotiations were impeded in any way by Dairyland's refusal to defend, nor was there any showing that the claim could have been settled for less than $30,000 if Dairyland had participated. Therefore, the $20,000 excess of the settlement over Dairyland's policy limit did not result from Dairyland's refusal to defend, and there would be no basis for holding it liable therefor. It is doubtful if any jurisdiction would have held Dairyland liable for the $20,000 excess under these facts.[87]

Thus, in all of the cases, only the dictum of *Universal Underwriters* stands against the recognition of a duty of a primary insurer to protect the interest of the excess insurer. And it can be questioned whether the statement of the Arizona Supreme Court was really the "*considered* dicta"[88] which a federal court of appeals is bound to follow.[89]

C. California Cases

A federal court in California recognized the duty of a primary in-

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mary coverage and the Universal policy was excess. Therefore, Dairyland's refusal to defend was wrongful.

85. 452 F.2d 603 (9th Cir. 1971).

86. The court of appeals considered itself "bound to follow the considered dicta as well as the holdings of state court decisions" in a diversity case. *Id.* at 603-04.

87. The decision in *Rocky Mountain* itself is highly suspect. The court overextended *Universal Underwriters* when it concluded that a general doctrine had been announced denying subrogation in all instances. Since subrogation is an equitable doctrine, the decision in the state court case should have been confined to the inequities of the situation before the court. The excess carrier was simply asking for damages not caused by the primary carrier's failure to defend.

88. 452 F.2d at 603 (emphasis added).

89. The Arizona court said: "There is no privy [sic] of contract between these two insurance companies nor is there any principle of law of which we are aware that would give Universal such a windfall because of Dairyland's mistreatment of its insured." 102 Ariz. at 520, 433 P.2d at 968. One wonders if that is really "considered" judicial language.

surer to the excess insurer in 1974 in *Peter v. Travelers Insurance Co.*[90] In that case, Travelers had primary coverage up to a limit of $250,000; Lloyd's had the excess. While the claim against the insured was pending, Travelers changed its claims procedures so that a branch office could settle for no more than $15,000 without home office approval. The company's agent in Los Angeles told the home office that there was a chance of avoiding liability, but that the value of the claim was about $100,000. There was little other communication between the branch and the home office; the home office did not authorize any payment over $15,000, so there were no real negotiations with the claimant.[91] The case was tried, judgment was entered for the claimant for $407,000, and this was settled for about $388,000. Lloyd's, the excess carrier, then sued Travelers, the primary carrier, for the $138,000 for which it became liable because of Travelers' wrongful refusal to settle.

The district court said that under *Crisci v. Security Insurance Co.*, [92] Travelers would be liable to the insured, since failure to even consider what settlement would be reasonable is more clearly wrongful conduct than the refusal of a reasonable offer.[93] Because Lloyd's was subrogated to the right of the insured, Travelers must pay the full amount of the loss, since the loss to the excess insurer was caused by Travelers' refusal to negotiate above $15,000.[94]

Another California decision, *Lear Sinegler v. Employers Surplus Lines Insurance Co.*,[95] held that a first excess insurer owes the same duty of good faith to a second excess insurer. In this case, the insured had a $500,000 primary policy with Lumberman's Mutual and a first excess policy with Employers Surplus Lines for an additional $500,000. There was a second excess layer with Lloyd's affording coverage of $4,000,000 in excess of the underlying first million.

Severe injuries had rendered the claimant a quadriplegic and his recovery appeared likely. He demanded $1,000,000 and the primary insurer offered its $500,000 primary limit, recommending that the first excess layer make its limit available. Employers Surplus Lines refused to extend settlement authority up to $500,000 and the case proceeded to

90. 375 F. Supp. 1347 (C.D. Cal. 1974).

91. There were apparently offers by the claimant to settle for something less than $225,000.

92. 66 Cal. 2d 425, 426 P.2d 173, 58 Cal. Rptr. 13 (1967).

93. 375 F. Supp. at 1349.

94. *Id.* at 1350. It should also be possible for an excess carrier to recover punitive damages from a primary carrier if its action is based on a subrogation theory. Recovery of punitive damages was clearly recognized in *Crisci*. It appears that an excess carrier has sought punitive damages in only one case, *Fireman's Fund Ins. Co. v. Security Ins. Co.*, 72 N.J. 63, 367 A.2d 864 (1976). By stating that "the necessary requisites to an award of punitive damages are not present", the court strongly implied that punitive damages would be awarded in a proper case. *See generally id.*

95. No. C-68324 (Cal. Super. Ct. May, 1976).

trial, resulting in a jury verdict of $2,733,131. Thereafter, Lloyd's settled the case for $1,350,000 above the primary and first layer payments. Proceeding on a subrogation theory, Lloyd's sued Employers Surplus Lines and was awarded the full amount of $1,350,000 plus $270,000 interest.[96]

Further support for the duty of the primary insurer to the excess insurer was demonstrated in the next few years by both the Ninth Circuit Court of Appeals[97] and by three different districts of the California appellate courts.[98] Hopefully, the California Supreme Court will adopt this view[99] if and when it is called upon to decide the issue.[100]

D. Choices of Action for the Excess Insurer

When a primary insurer breaches its duty to the excess insurer to offer its full policy limit, if necessary, to effectuate a settlement, the excess insurer has a choice: it can attempt to negotiate a settlement with the claimant, and then recover the amount thereof from the primary carrier up to the primary policy limit;[101] or it can wait until after a judgment is entered against the insured, and then recover from the primary carrier the amount by which the judgment exceeds the claimant's offer of settlement, plus the amount of the primary policy limit.[102]

This does not mean that an excess insurer can settle for any amount it chooses and automatically recover from the primary insurer its policy limits. In order to recover, the excess insurer must prove that the amount of the settlement was reasonable, and that the primary insurer

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96. No appeal was filed and Employers Surplus Lines agreed to make payment.

97. *See generally* Valentine v. Aetna Ins. Co., 564 F.2d 292 (9th Cir. 1977).

98. *See generally* Kaiser Foundation Hospitals v. North Star Reinsurance Corp., 90 Cal. App. 3d 786, 153 Cal. Rptr. 678 (1979)(2d District); Transit Cas. Co. v. Spink Corp., 94 Cal. App. 3d 124, 156 Cal. Rptr. 360 (1979)(3d District); Northwestern Mut. Ins. Co. v. Farmers Ins. Group, 76 Cal. App. 3d 1031, 143 Cal. Rptr. 415 (1978)(4th District)(primary insurer has duty to exercise good faith in allocating claims to certain policy years, since this allocation will affect liability of excess carrier which must pay claims after aggregate of paid claims for a policy year exceeds limit of primary coverage).

99. See text accompanying notes 135-145 *infra* for a discussion of the reasons supporting this view.

100. Some question has been raised concerning the possible position of the California Supreme Court because of its holding that the *insured* does not owe a duty to the excess insurer to attempt to settle within the amount of a self-insured retention. *See* Commercial Union Assurance Companies v. Safeway Stores, Inc., 26 Cal. 3d 912, 921, 610 P.2d 1038, 1043, 164 Cal. Rptr. 709, 714 (1980). However, only the insured was involved in that appeal; the primary insurer was not. There was no indication that the primary insurer refused to participate in any proposed settlement, or was guilty in any way of wrongful conduct. The California Supreme Court in *Commercial Union* did not state its position on the primary/excess insurer relationship, and it seems unlikely that it will have occasion to do so in any subsequent proceedings in this case. However, the court's discussion of the appellate court cases involving the primary/excess relationship seems to indicate its approval of the rule adopted therein imposing a duty on the primary insurer.

101. *See generally* Westerholm v. 20th Century Ins. Co., 58 Cal. App. 3d 628, 130 Cal. Rptr. 164 (1976); Pacific Indem. Co. v. Liberty Mut. Ins. Co., 239 Cal. App. 2d 346, 48 Cal. Rptr. 667 (1966).

102. *See generally* Peter v. Travelers Ins. Co., 375 F. Supp. 1347 (C.D. Cal. 1974).

therefor had a duty to pay the amount thereof, up to its policy limit.[103] No showing of bad faith is required in this situation. "The only default of the primary insurer [is its] refusal to contribute its policy limits to the settlement arranged by the excess insurer, and the only injury suffered by the excess insurer [is] the loss of the primary insurer's contribution of its policy limits."[104] In order to recover from the primary insurer an amount in excess of the primary limit, however, the excess insurer must also show that the bad faith refusal of the primary insurer to tender its policy limit was the cause of the resulting excess judgment. The primary insurer will be liable if its "unreasonable refusal to settle within its policy limits resulted in loss to the excess insurer" because the excess insurer was forced to pay an amount for which it would not otherwise have been liable.[105]

Primary insurers have sometimes argued that they cannot be liable in the event of a settlement because they did not authorize the settlement, and the settlement did not arise out of a judgment against the insured, as required by the policy. Courts have rejected this contention, stating that when the potential loss and the proposed settlement far exceed the policy limits, the excess insurer may, but need not, await the outcome of the tort action against the insured. The excess insurer may also make a good faith settlement above the primary policy limits. The defaulting primary insurer is fully protected by the requirement that the excess insurer must prove that the settlement was negotiated in good faith and for a reasonable amount.[106]

DUTY OF THE INSURED TO THE INSURER

A. Is There a Duty?

The relationship between insured and insurer as concerns a deductible is not significantly different from the excess/primary relationship. It is obvious that in the primary/excess situation, the primary is merely acting as a sort of "deductible". Thus, the duty owed by an insured to contribute its deductible towards a settlement should be identical to the duty owed by a primary carrier to contribute to a settlement arranged by the excess carrier. Therefore, where the duty of the primary carrier to the excess carrier is recognized, as is almost universally the case,[107] a

103. *See, e.g.*, 58 Cal. App. 3d at 628, 130 Cal. Rptr. at 164; 239 Cal. App. 2d at 346, 48 Cal. Rptr. at 667; Continental Cas. Co. v. Reserve Ins. Co., 307 Minn. 5, 238 N.W.2d 862 (1976).

104. Northwestern Mut. Ins. Co. v. Farmers Ins. Group, 76 Cal. App. 3d 1031, 1049, 143 Cal. Rptr. 415, 426 (1978).

105. *Id.* at 1050, 143 Cal. Rptr. at 426.

106. *See generally* Fireman's Fund Ins. Co. v. Security Ins. Co., 72 N.J. 63, 367 A.2d 864 (1976).

107. See note 62 *supra*.

comparable duty of the insured to its insurer should also be recognized.

Even without an analogy to the primary/excess relationship, the insured should owe a duty to its insurer. Under the basic law of contribution and indemnity, a person who bears a loss because of the wrongful conduct of another has a remedy against the latter. Clearly, an insured's unreasonable refusal to offer its deductible in settlement should be deemed wrongful conduct by the insured.

It is fundamental that an implied covenant of good faith and fair dealing forms a part of every insurance agreement. This covenant requires that neither the insurer nor the insured do anything to injure the right of the other to receive the benefit of the contract of insurance.[108] The well recognized obligation of an insurer to attempt good faith settlement of lawsuits brought against its insured derives from this implied covenant.

Beyond this reciprocal obligation[109] of good faith and fair dealing, an insurer also has a right to insist upon the reasonable cooperation of the insured[110] which is correlative to the insurer's duty to defend lawsuits brought against the insured.[111] Given the insured's duty to reasonably cooperate, the conclusion is clear that an insured must have an obligation to tender the full amount of its deductible towards a reasonable settlement negotiated by the carrier.

Failure to tender a deductible towards a reasonable settlement is a breach of the insured's duties to the insurer. For example, the insurer's right to the cooperation of the insured has been held to prohibit an insured from arbitrarily demanding settlement on its own terms and conditions without consideration of the interests of the carrier.[112] It has also been held that the refusal, in bad faith, of an insured to contribute to a settlement over policy limits bars the insured from claiming, after a failure to settle and an excess judgment, that the insurer acted in bad

108. *See generally* 375 F. Supp. at 1347; Crisci v. Security Ins. Co., 66 Cal. 2d 425, 426 P.2d 173, 58 Cal. Rptr. 13 (1967); Kaiser Foundation Hospitals v. North Star Reinsurance Corp., 90 Cal. App. 3d 786, 153 Cal. Rptr. 678 (1979).

109. Transit Cas. Co. v. Spink Corp., 94 Cal. App. 3d 124, 131, 156 Cal. Rptr. 360, 364 (1979)("The implied covenant of good faith and fair dealing does not burden the carrier alone; it is reciprocal, binding the policyholder as well as the carrier.")

110. A typical cooperation clause provides that "the insured shall cooperate with the company and, upon the company's request, assist in making settlements." R. KEETON, INSURANCE LAW: BASIC TEXT app. G, at 655 (1971).

The phrase "shall . . . assist in making settlements" clearly encompasses a direct obligation to act in good faith in tendering a deductible amount towards a reasonable settlement. Thus, the arbitrary refusal to tender a deductible would appear to constitute a breach of the standard cooperation clause.

111. *See generally* Larraburu Bros., Inc. v. Royal Indem. Co., 604 F.2d 1208 (9th Cir. 1979).

112. *See* Traders & Gen. Ins. Co. v. Redco Oil & Gas Co., 129 F.2d 621, 626 (10th Cir. 1942).

faith in not settling within policy limits.[113] Since the unreasonable refusal of an insured to contribute any or all of its deductible to a settlement in excess of the deductible amount is tantamount to a refusal to settle except upon the terms and conditions set by the insured, it should be considered as a breach of the duty to act in good faith.[114]

If a settlement negotiated by the insurer is reasonable from the standpoint of the merits and the insured's best interests, the only reason for the failure by the insured to tender all of its deductible would be to capriciously gamble, at the expense of the insurer, for a verdict less than the deductible amount. The insured will be legally liable for the deductible whether the case is settled at the recommended figure, settled at another figure above the deductible amount, or tried through to judgment in excess of the deductible. Unless the insured will also be held responsible for any excess, only the insurer's money is at risk. On the other hand, the insurer is given the choice of settling the case and contributing more than its fair share of the settlement amount, or not settling and risking a much higher judgment at trial. Even if the case does settle at a later point, the insurer will be forced to pay additional legal costs and, because additional costs will have been incurred by the claimant, it is highly likely that the claimant will insist upon a higher settlement figure even if the case does eventually settle. Putting it simply, the insured blackmails the insurer when it refuses to tender its deductible amount.

It may be argued that an insured has no implied good faith duty to contribute its deductible towards a reasonable settlement because the insured does not control the litigation.[115] This argument does not withstand scrutiny. First, the insured does control the decision of whether or not it will contribute its deductible. Second, the insured exercises a degree of actual control over the entire litigation when it refuses to tender all or part of its deductible towards a reasonable settlement. This also gives rise to the duty to act in good faith.

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113. *See generally* Riley v. State Farm Mut. Ins. Co., 420 F.2d 1372 (6th Cir.), *cert. denied*, 399 U.S. 928 (1970); Knobloch v. Royal Globe Ins. Co., 46 A.D.2d 278, 362 N.Y.S.2d 492 (1974).

114. This discussion assumes the insurer has reasonably attempted to induce the insured to tender its deductible. *See* Young v. American Cas. Co., 416 F.2d 906, 910 (2d Cir. 1969), *cert. denied*, 396 U.S. 997 (1970).

115. The right of an insurer to control the lawsuit is often given as one of the reasons for the requirement that an insurer has a duty to settle in good faith. The basis for judicial imposition on liability insurers of a duty to exercise good faith or due care with respect to opportunities to settle within the policy limits is that "the company has exclusive control over the decision concerning settlement within policy coverage, and company and insured often have conflicting interests as to whether settlement should be made." Keeton, *supra* note 32, at 1138.

B. California Cases

In line with the generally accepted view that the insured owes a duty of good faith to its insurer, a California appellate court recently held that an insurer has a cause of action against its insured where the insured wrongfully refuses to tender its deductible amount to effect a reasonable settlement.[116] In *Transit Casualty*, the insured had a $15,000 deductible, there was $100,000 primary coverage, and $1,000,000 excess coverage. It appeared that the claim could have been settled for $300,000, but both the insured and the primary insurer refused. The insured said that its refusal to settle was based on the opinion of its insurance broker, a specialist in professional liability coverage, that settlement of the claim might impair its future insurability, and might also be harmful to the engineering industry generally.[117] However, no evidence was offered at trial that this was true, so the court found that it was bad faith for the insured to refuse to settle. The court held that the insured had a duty to attempt to settle a claim, even though the policy had a clause requiring the insured's consent to any settlement.[118] The court construed this clause narrowly, since there is a public interest in settling lawsuits, and stated that it would not permit an *unreasonable* rejection of a settlement offer. Thus, the insured would be liable to the insurer[119] for any injury suffered by the latter because of the insured's unreasonable refusal to settle.[120]

The view that the insured owes a duty of good faith to its insurer received further support from a California appellate court in *Kaiser Foundation Hospitals v. North Star Reinsurance Corp*.[121] In this case, the insured hospital had primary coverage with a limit of $1,000,000 for the aggregate of all claims within a policy year, subject to a $25,000 deductible for each malpractice claim. It also had a policy covering the excess over the deductible and primary coverage. The excess carrier claimed that the insured and primary insurer, by improperly assigning one or more claims to a certain policy year, had exhausted the annual aggregate limit and thus brought the excess policy into play prematurely. In reversing the judgment of the trial court because of error in

116. *See generally* Transit Cas. Co. v. Spink Corp., 94 Cal. App. 3d 124, 156 Cal. Rptr. 360 (1979).

117. Insured was a firm of consulting engineers which was sued in connection with a construction site accident. The insurers carried its professional liability insurance.

118. The policy provided that, if consent was refused, the insurer would only be liable for the amount it would have paid if the settlement had been approved. 94 Cal. App. 3d at 129 n.1, 144 Cal. Rptr. at 363 n.1.

119. In this case, the excess insurer.

120. It appeared that the excess insurer may have been contributorily negligent in its handling of the claim. Under the doctrine of comparative negligence, this might reduce the recovery from the insured. 94 Cal. App. 3d at 138, 156 Cal. Rptr. at 369.

121. 90 Cal. App. 3d 786, 153 Cal. Rptr. 678 (1979).

the admission of evidence, the court said that "[t]here can be no question that . . . the duty of good faith and fair dealing was owed to the excess insurer by . . . the . . . insured as well as by . . . the primary insurer."[122]

The first harbinger of a contrary position came in *Commercial Union Assurance Companies v. Safeway Stores, Inc.*,[123] and the rejection of any duty of an insured to settle became the law of California when the California Supreme Court adopted the opinion of the appellate court in affirming its judgment.[124] In *Commercial Union*, the California Supreme Court expressly disapproved *Transit Casualty* as to its holding that an insured has a duty to its insurer to attempt in good faith to settle.[125] It also distinguished *Kaiser*[126] and another case,[127] indicating that the duty of good faith required by those cases was for the insured not to "engage in unconscionable acts which would subvert the legitimate rights and expectations of the . . . insurance carrier."[128]

The court in *Commercial Union* thus accepted the fact that the duty of good faith and fair dealing runs in both directions between insured and insurer, but felt that the extent of the duty depends on the contract between the parties, and their legitimate expectations arising therefrom.[129] The insured buys liability insurance for the purpose of protecting himself, and can reasonably expect that, in the conduct of the defense and settlement of the claim, the insurer will give him the greatest protection possible.[130] The insurer, however, cannot reasonably expect the insured to accept a settlement offer in order to protect the insurer from exposure, as such "protection . . . is simply not the object of the bargain."[131] It is the view of the California Supreme Court that the insurer did not issue its policy with any expectation of favorable treatment by the insured, and that the insured did not in any way

122. *Id.* at 792, 153 Cal. Rptr. at 682.

123. 26 Cal. 3d 912, 610 P.2d 1038, 164 Cal. Rptr. 709 (1980).

124. *Id.* There was $50,000 primary coverage, $50,000 self-insured retention, and $100,000 to $20,000,000 excess coverage. It was alleged that the claim could have been settled for no more than $60,000. The case was tried and judgment entered for $125,000. Excess insurer sued insured and primary insurer for the $25,000 it was required to pay on the judgment.

125. *Id.* at 921, 610 P.2d at 1043, 164 Cal. Rptr. at 714.

126. Kaiser Foundation Hospitals v. North Star Reinsurance Corp., 90 Cal. App. 3d 786, 153 Cal. Rptr. 678 (1979).

127. Liberty Mut. Ins. Co. v. Altfillisch Constr. Co., 70 Cal. App. 3d 789, 139 Cal. Rptr. 91 (1977).

128. Commercial Union Assurance Companies v. Safeway Stores, Inc., 26 Cal. 3d 912, 921, 610 P.2d 1038, 1043, 164 Cal. Rptr. 709, 714 (1980). In *Kaiser*, the breach of faith was "the aggravated conduct on the part of the insured and the primary carrier in taking advantage of the excess carrier." *Id.* at 920, 610 P.2d at 1043, 164 Cal. Rptr. at 714. In *Liberty Mutual*, the breach was an action taken by the insured which cut off the insurer's right of subrogation, contrary to an express subrogation clause in the insurance policy.

129. *Id.* at 918, 610 P.2d at 1041, 164 Cal. Rptr. at 712.

130. *Id.*

131. *Id.* at 919, 610 P.2d at 1042, 164 Cal. Rptr. at 713.

promise that it would attempt to settle to protect the insurer.[132] In fact, the court expressly states its belief that "the primary reason excess insurance is purchased is to provide an available pool of money in the event that the decision is made to take the gamble of litigating."[133]

Thus, the California Supreme Court seems to have given carte blanche to insureds to refuse to tender a deductible amount in settlement, and to proceed to litigate any claim to the last ounce of the insurer's resources.[134] It seems highly questionable if this really reflects the reasonable expectations of the parties to the insurance contract, and such a rule is also open to serious criticism as a matter of public policy.

THERE SHOULD BE A DUTY BETWEEN PRIMARY AND EXCESS INSURER AND BETWEEN INSURED AND INSURER

Two basic principles of negligence law, which are clearly accepted in California as well as many other states, seem to compel the recognition of a duty by a primary insurer to an excess insurer and by an insured to its insurer to make a good faith effort to settle a claim and thereby protect the other party's interest.

> (1) Every one is responsible, not only for the result of his willful acts, but also for an injury occasioned to another by his want of ordinary care or skill in the management of his property or person, except so far as the latter has, willfully or by want of ordinary care, brought the injury upon himself.[135]
>
> (2) Reasonable foreseeabiiity of harm creates a duty of care.[136]

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132. *Id.* at 920, 610 P.2d at 1042, 164 Cal. Rptr. at 713. The only other case which expresses a similar view is *Hayes Bros., Inc. v. Economy Fire & Cas. Co.*, 634 F.2d 1119 (8th Cir. 1980)(applying Iowa law). In *Hayes*, the court said that the insured is not held to the same standard as the insurer for failure to accept a settlement demand. However, this is probably dictum, and in any case is not applicable to a deductible situation. *Id.* at 1124. In *Hayes*, there was $50,000 of insurance coverage; insurer rejected offers to settle within this policy limit; shortly before trial, there was an offer to settle for $90,000, and insurer tendered its $50,000 policy limit; insured refused to pay $40,000; in view of the prior bad faith of the insurer in refusing to settle, it is doubtful if the insured was guilty of bad faith toward the insurer in refusing to pay $40,000 toward a last-minute settlement.

133. 26 Cal. 3d at 919, 610 P.2d at 1042, 164 Cal. Rptr. at 713. It can well be argued that the rule of *Commercial Union* should be limited to its particular facts ($50,000 primary coverage, then a $50,000 self-insured layer, then $20,000,000 excess coverage). Perhaps such a buyer of insurance is indeed buying the opportunity to gamble on litigating any claim it wishes. It is doubtful if the same could be said of an insured in the more common situation, where perhaps the deductible is $5,000, the primary coverage is $100,000, and there is no excess coverage at all. The fact that the court repeatedly refers to the "duty owed to an excess insurance carrier" at least provides a basis for limiting the application of the decision in *Commercial Union*.

134. An insurer could impose a duty of good faith settlement on the insured by using appropriate express language in the policy. *Id.* at 921, 610 P.2d at 1043, 164 Cal. Rptr. at 714.

135. Rowland v. Christian, 69 Cal. 2d 108, 111-12, 443 P.2d 561, 563, 70 Cal. Rptr. 97, 99 (1968).

136. *See* Weirum v. RKO Gen., Inc., 15 Cal. 3d 40, 46, 539 P.2d 36, 41, 123 Cal. Rptr. 468, 471 (1975); Rodriguez v. Bethlehem Steel Corp., 12 Cal. 3d 382, 399, 525 P.2d 669, 680, 115 Cal. Rptr. 765, 776 (1974); Dillon v. Legg, 68 Cal. 2d 728, 739-41, 441 P.2d 912, 919-21, 69 Cal. Rptr. 72, 79-81 (1968).

Application of these principles to the insured/primary/excess relationship should lead to "reciprocal duties of care in the conduct of settlement negotiations when a damage claim threatens to exceed" a deductible amount or the limit of primary coverage, since in such case injury to another party is reasonably foreseeable.[137]

This view is supported by important policy considerations underlying our judicial and liability insurance systems. First, when the insured or primary insurer breaches its good faith duty to settle it imperils the public interest in fair and reasonable settlement of lawsuits. Faced with a refusal to settle by the insured or primary insurer, the other party involved in the insurance coverage must either proceed to trial and be sure of full payment of the deductible or primary limit, or pay the full amount of a settlement itself and risk losing the contribution of the deductible or primary limit.[138]

Second, notions of equity and fair play require that a party not be permitted to gamble with the money of another.[139] When there is an offer to settle at or near the amount of the deductible or primary limit, the insured or primary carrier has a strong incentive to refuse settlement and go to trial, since it has nothing to lose. It seems only fair in such a situation to force it to gamble with its own money, by holding it responsible for any injury to the other party resulting from its refusal to settle. The reasoning here should be exactly the same as in requiring an insurer to give full consideration to the interest of its insured.[140]

Third, holding insureds and primary insurers to a duty to make a good faith attempt to settle will reduce the cost of defense of claims. If no such duty is imposed, an insurer with a deductible, or an excess insurer, will be forced to participate fully in the defense and settlement negotiations, rather than relying, at least to some extent, on the handling of the claim by the insured or primary insurer. This participation will substantially increase defense costs.

Fourth, failure to recognize a duty to settle will distort insurance premium rate structures. Insurers charge lower rates for excess cover-

137. Transit Cas. Co. v. Spink Corp., 94 Cal. App. 3d 124, 134, 156 Cal. Rptr. 360, 366 (1979).

138. If the case proceeds to trial, and judgment is entered for an amount exceeding the deductible or primary limit, as the case may be, the insured or primary carrier will have to pay, just as if there had been no settlement offer. If the insurer settles, however, and thereafter seeks to recover the deductible or primary coverage, it will succeed in doing so only if it establishes that the settlement was reasonable and that it was bad faith for the other party to refuse to settle. Given this perilous choice, many insurers would elect to go to trial rather than settle.

139. *Contra*, Commercial Union Assurance Companies v. Safeway Stores, Inc., 26 Cal. 3d 912, 919, 610 P.2d 1038, 1042, 164 Cal. Rptr. 709, 713 (1980). See notes 132-133 and accompanying text *supra*.

140. *See generally* Crisci v. Security Ins. Co., 66 Cal. 2d 425, 426 P.2d 173, 58 Cal. Rptr. 13 (1967).

age,[141] or for policies with a deductible clause, because they expect to pay out less in claims than they would if they covered the insured exposure from the first dollar of every claim. Their rates are based, however, on the reasonable expectation that the defense and settlement of claims will be handled just the same as if one party were to bear the entire liability for any settlement or judgment. This rate structure does not envision a rule which permits another party to greatly expand the insurer's potential liability.[142]

Fifth, as to the duty of a primary insurer to the excess insurer, the premium has been structured to take into account the fact that the primary insurance company will be undertaking the duty of investigation of the claim and the defense of the litigation, including the payment of defense attorneys' fees and expenses.[143] Recognizing this fact, the excess insurer's premiums are normally established on the basis of what the liability exposure for loss payment would be, taking into consideration the fact that information regarding the investigation and defense will be obtained from the primary insurer's representatives, including its defense counsel.[144]

It is sometimes suggested that a rule which puts pressure on the insured or primary insurer to settle will encourage claimants to make unreasonable demands for settlement at or near the deductible or primary limit, and that such demands will be accepted for fear of the insured or primary insurer being responsible for an excess judgment if the demand is refused. This same argument has been made in cases involving the duty of the insurer to protect the insured, and the courts have repeatedly rejected it.[145] There is no indication that imposition of a duty to settle on either insurer or insured has had a measurable effect on claims experience. And even if it did lead to some increase in the

141. This is the case as to both a "true" primary/excess insurance relationship, where one insured is covered by several policies, one expressly affording primary coverage and the other expressly affording excess coverage, and the primary/excess relationship which results when two policies insure two insureds but, by policy provision or by operation of law, one becomes primary and the other excess, (e.g., where an owner and driver of a vehicle each is insured by his own policy). In the latter case, each policy was intended to provide primary coverage to its named insured. However, both insurers knew their policies would provide primary coverage in some instances and excess coverage in others, and their total premiums were presumably set with that in mind. Northwestern Mut. Ins. Co. v. Farmers Ins. Group, 76 Cal. App. 3d 1031, 1047-48, 143 Cal. Rptr. 415, 424-25 (1978).

142. *See* Valentine v. Aetna Ins. Co., 564 F.2d 292, 298 (9th Cir. 1977); Continental Cas. Co. v. Reserve Ins. Co., 307 Minn. 5, 9, 238 N.W.2d 862, 865 (1976).

143. The primary insurer normally has the sole right to negotiate settlements. Peter v. Travelers Ins. Co., 375 F. Supp. 1347, 1350 (C.D. Cal. 1974).

144. Transit Cas. Co. v. Spink Corp., 94 Cal. App. 3d 124, 135, 156 Cal. Rptr. 360, 367 (1979)("The premium charged by the primary insurer supports more localized claim adjustment facilities than those of the excess carrier.").

145. *See generally* Rova Farms Resort, Inc. v. Investors Ins. Co. of America, 65 N.J. 474, 323 A.2d 495 (1974).

amount paid out in settlements, this increase would be offset, in whole or in part, by savings in litigation costs and damage awards.

STRICT LIABILITY SHOULD BE THE STANDARD

As we have indicated previously, there has been considerable support for applying a rule of strict liability to the duty of an insurer to its insured to accept an offer of settlement within its policy limit.[146] According to this view, if an insurer rejects a claimant's offer to settle within the policy limit, the insurer will thereafter be liable for the full amount of any judgment against the insured, without regard to whether or not the insurer acted in good faith. The reasoning is that any loss which results from the insurer's decision to contest the claim should be borne by those who stand to gain from taking the risk, i.e., the insurer and its policyholders.[147] This position seems eminently sound, and the same reasoning supports application of strict liability to the insured/insurer and primary/excess situations.

In all three cases, the party who is secondarily liable has a right to expect that the party who is primarily liable will offer the amount of its coverage or deductible where necessary to effect an end to the litigation.[148] The party who is primarily liable should not be permitted to further its own interests by rejecting opportunities to settle within the policy limits or deductible unless it is also willing to absorb losses which may result from its failure to settle.[149]

This view also helps to eliminate the serious conflict of interest problems which are inherent in these situations.[150] A settlement is almost always in the best interest of the party secondarily liable, because this will assure its non-liability, but it will often be in the interest of the party primarily liable not to settle.[151] This is especially true as the offer

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146. *See generally* Note, *Excess Liability: Reconsideration of California's Bad Faith Negligence Rule*, 18 STAN. L. REV. 475, 483 (1966). See notes 48-56 and accompanying text *supra*.

147. Insurance companies sometimes adopt "no settlement" or "selective settlement" programs to numb the public's claim-consciousness, to discourage fraudulent claims, to create a tight-fisted image for plaintiffs' attorneys, or to establish favorable legal precedents. A strict liability rule would protect the insured from these "institutional considerations" which often affect settlement decisions.

148. *See* Crisci v. Security Ins. Co., 66 Cal. 2d 425, 431, 426 P.2d 173, 177, 58 Cal. Rptr. 13, 17 (1967).

149. *Id.*

150. In most legal relationships determination of the merits of conflicting interests by one of the parties to the conflict is forbidden. No man can be judge in his own case; no trustee may weigh his personal interest against that of his beneficiary; no agent may evaluate his personal profit against that of his principal; and no public officer may balance private gain against public interest.
Merritt v. Reserve Ins. Co., 34 Cal. App. 3d 858, 874, 110 Cal. Rptr. 511, 521 (1973).

151. *Id.* at 870, 110 Cal. Rptr. at 519 (it is always in the interests of the insured to settle). In *Rova Farms Resort, Inc. v. Investors Ins. Co. of America*, 65 N.J. 474, 498, 323 A.2d 495, 508 (1974), the court stated:

to settle nears or reaches the limit of primary liability.

A rule of strict liability will also eliminate the substantial burden of proving bad faith or negligence which the traditional standards impose on a party who seeks to recover the amount of a judgment in excess of the primary liability. Under a strict liability standard, the party secondarily liable will meet its burden of proof simply by establishing that the party primarily liable rejected an offer of settlement within the limit of the primary liability.[152]

Strict liability would eliminate the confused and unpredictable results reached under traditional standards of liability. It would also eliminate the uncertainty and problems in interpretation of traditional standards of liability. The strict liability standard is clear and easy to apply to any excess liability case. If the injured party's demand is below the primary policy limit or deductible, the party primarily liable will be responsible for any subsequent judgment if it rejects that demand. This would be the sole factual determination necessary in an excess liability case if a strict liability standard were adopted.[153]

Some courts and commentators have expressed the fear that strict liability will cause a substantial increase in insurance companies' costs and, consequently, an increase in premiums.[154] Although cost predictions are extremely difficult to make, careful analysis suggests that any such increase would be small, if indeed there was any increase at all. The party primarily liable is already held responsible for an excess judgment in a substantial portion of the cases which have applied a bad faith or negligence standard,[155] and it seems unlikely that recoveries

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> Yet however much the carrier considers the interests of its insured in pondering the decision as to settlement, the moment it decides not to settle, it in effect, however reasonably, sacrifices the interests of the insured in order to promote its own. It is always to the benefit of the insured to settle and thereby avoid the danger of an excess verdict.

152. Strict liability is currently the rule where an excess carrier arranges a reasonable settlement and then seeks to recover the amount of the primary limit from the primary carrier. The excess carrier need only show that settlement was reasonable and that the amount was equal to or in excess of the primary limit. *See generally* Westerholm v. 20th Century Ins. Co., 58 Cal. App. 3d 628, 130 Cal. Rptr. 164 (1976); Pacific Indem. Co. v. Liberty Mut. Ins. Co., 239 Cal. App. 2d 346, 48 Cal. Rptr. 667 (1966).

Only where the excess carrier attempts to recover an amount in excess of the policy limits of the primary insurer does it have to show that the primary carrier refused in bad faith to contribute its policy limits. *See generally* Northwestern Mut. Ins. Co. v. Farmers' Ins. Group, 76 Cal. App. 3d 1031, 143 Cal. Rptr. 415 (1978).

153. 66 Cal. 2d at 431, 426 P.2d at 177, 58 Cal. Rptr. at 17.

154. *See, e.g.*, Blue Bird Taxi Corp. v. American Fid. & Cas. Co., 26 F. Supp. 808, 810 (E.D.S.C. 1939); Comment, *Insurance: Excess Recovery—Liability Insurer Who Refused Settlement Within the Policy Limits Held Liable for Excess Recovery and Mental Damages*, 43 N.Y.U. L. REV. 199, 204 (1968); Comment, *Strict Liability for Insurance Companies in Excess Judgment Suits*, 23 U. FLA. L. REV. 201, 205-06 (1970).

155. For insurer/insured cases in which the insurer was absolved of liability, *see generally* Murach v. Massachusetts Bonding & Ins. Co., 339 Mass. 184, 158 N.E.2d 338 (1959); Knobloch v. Royal Globe Ins. Co., 46 A.D.2d 278, 362 N.Y.S.2d 492 (1974). See note 56 *supra*.

For primary/excess cases in which the primary insurer was absolved of liability, *see generally*

will be materially increased under strict liability. Furthermore, any increase in costs of settlement would be offset by avoiding expensive litigation costs, such as attorneys' fees and investigation expenses.[156]

CONCLUSION

In the insured/insurer and primary insurer/excess insurer relationships, a rule of "triangular reciprocity" should be applied.[157] Each party to the relationship should have mutual obligations to the other parties, and these obligations should include a duty to settle within the limits of that party's liability where such a settlement is possible. Where a party fails to meet its duty to accept a reasonable settlement,[158] it should be liable for the full amount of any judgment entered thereafter.

When the party with primary liability chooses not to settle, and thereby gambles on the outcome of litigation, it seems reasonable that it should "bear the unhappy financial result of that unilateral decision, since it alone profits from [a successful] result of the gamble."[159] Such a rule enables the party primarily liable "to pursue its own interests . . . without sacrificing those of [the party secondarily liable]."[160]

Nor will the proposed rules force the party primarly liable to accept every offer of settlement which is within its limit of liability.[161] Unreasonable settlement demands will still be rejected when a party's best judgment indicates a good chance of a better result in further negotia-

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Offshore Logistics Servs., Inc. v. Arkwright-Boston Mfrs. Mut. Ins. Co., 469 F. Supp. 1099 (E.D. La. 1979); Centennial Ins. Co. v. Liberty Mut. Ins. Co., 62 Ohio St. 2d 221, 404 N.E.2d 759 (1980).

156. *See* Kelly, *The Workable Sanction and Solution in Excess Liability Cases: Strict Liability for Insurance Carriers*, 10 U.S.F. L. REV. 159, 167 (1975); Comment, Crisci's *Dicta of Strict Liability for Insurers' Failure to Settle: A Move Toward Rational Settlement Behavior*, 43 WASH. L. REV. 799, 815 (1968).

157. Transit Cas. Co. v. Spink Corp., 94 Cal. App. 3d 124, 134, 156 Cal. Rptr. 360, 366 (1979).

158. 66 Cal. 2d at 430, 426 P.2d at 177, 58 Cal. Rptr. at 17.

159. Rova Farms Resort, Inc. v. Investors Ins. Co. of Am., 65 N.J. 474, 500, 323 A.2d 495, 509 (1974).

160. *Id.* The court added:

> It is contended by some that a new rule, requiring the carrier in all cases to bear the financial consequences of its failure to offer its policy in settlement, will make it easier for plaintiffs' counsel to extract money from insurers by means of nuisance suits, will increase claims costs, and will thereby raise premium rates substantially. We note, however, that under the doctrine presently in force the company, supposedly, is already making settlement decisions as though it would be liable for the entire sum of any adverse verdict. Therefore, a carrier should be no more willing to settle under such a broadened rule than it is at present, and should in such an event prove no easier prey to unreasonable plaintiff demands than now. Were a carrier to settle more often or at higher figures than it presently does, this fact would only suggest that the company has been ignoring the standards set forth by the Court.

Id at 500 n.7, 323 A.2d at 509 n.7.

161. *See* Comment, *Insurer's Strict Liability for Entire Judgment*, 13 SAN DIEGO L. REV. 375, 380 (1968)(suggesting that injured parties will make high demands to provoke rejection, thus exposing the insurer to excess judgment liability).

tion or litigation. And most claimants will continue to keep their demands at reasonable levels rather than risk a judgment for an amount less than the proposed settlement.[162]

Each party to the liability insurance relationship has a reasonable expectation that no other party will be permitted to further its own interests by rejecting settlement opportunities unless it is also willing to absorb losses which may result from its failure to settle.[163] Elementary justice requires that, where the interests of the parties conflict, he who "may reap the benefits . . . should also suffer the detriments of [his] decision."[164]

162. Or even worse, a judgment for the defendant.
163. 66 Cal. 2d at 430, 426 P.2d at 177, 58 Cal. Rptr. at 17 (argument proposed by amicus curiae).
164. *Id.*